MOTION FILED
OCT 14 1981

No. 81-523

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

CONTAINER CORPORATION OF AMERICA, *Appellant,*

v.

FRANCHISE TAX BOARD, *Appellee.*

On Appeal From the Court of Appeal of California, First Appellate District

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT AND BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

The Committee on State Taxation of the Council of State Chambers of Commerce hereby respectfully moves for leave to file the attached brief *amicus curiae* in this case. The consent of the Attorney for the Appellant has been obtained. The consent of the Attorney for the Appellee was requested and refused.

The Council of State Chambers of Commerce (COUNCIL), organized in 1932, consists of 34 Chambers of Commerce. The Committee on State Taxation (COST), one of the three advisory committees of the COUNCIL, consists of 177 corporate members which conduct a substantial portion of the interstate and international business of the United States. One of COST's principal activities has been to work with the states and others toward developing fair and equitable national

standard in the income allocation and apportionment aspects of state taxation.

Member companies of COST are thus representative of that part of the nation's business sector which is most directly affected by state taxation of interstate and international business operations. COST is therefore vitally interested in cases such as this one which present issues significantly affecting the uniformity, certainty and fair apprortionment of state and local taxes.

The particular interest of COST in this case results from the presence of the following substantial question:

> Whether the Due Process Clause of the Fourteenth Amendment or the Commerce Clause of the Constitution of the United States was violated when the State of California included, for franchise tax purposes, the income of the foreign subsidiaries of Container Corporation of America in its "combined" apportionable base.

The United States Supreme Court has never decided the issue of whether the application by a state of a "worldwide combination" apportionment formula to a state taxpayer, such as Container Corporation, results in an arbitrary, unreasonable attribution of extraterritorial income to the state so as to offend the Due Process Clause of the Fourteenth Amendment and subject the taxpayer to multiple taxation prohibited by the Commerce Clause.

In an era of rapidly increasing state and local revenue needs, individual states are expanding efforts to maximize tax revenue from multistate and multinational businesses by taxing extraterritorial values. One method used by over-zealous states is an attempt to tax both hypothetical income (i.e., gross-up) and non-unitary intangible income. That method is being examined by this

Court in the current Term in the cases of *F. W. Woolworth Co.* v. *Taxation and Revenue Department of the State of New Mexico,* No. 80-1745 (Jurisdiction noted October 5, 1981), and *ASARCO, Inc. (formerly The American Smelting and Refining Co.)* v. *Idaho State Tax Commission,* No. 80-2015 (Jurisdiction noted October 5, 1981). Another method uses a "worldwide combination" formula. That method is being aggressively pursued by an increasing number of states, including Alaska, California, Colorado, Idaho, Illinois, Montana, North Dakota, Oregon, Utah and New York (for oil companies). Dozens of "worldwide combination" cases are now pending at various administrative and judicial levels. Establishment by this Court of Constitutional standards for fair apportionment in both the *Woolworth* and *ASARCO*-type cases and the "worldwide combination" cases is urgently needed. They are needed to assure a reasonably consistent and fair system of taxation throughout the nation which will (1) allow each state to receive its just share of the total tax contribution of the nation's business sector, (2) prevent inequity and (3) protect the Constitutional rights of multinational corporate taxpayers. This Court now has an opportunity to establish these standards by considering the "worldwide combination" issue in conjunction with the "gross-up" and non-unitary intangible income issues.

By this motion, COST seeks leave (1) to show that the decision of the Court of Appeal of California in this case is repugnant to longstanding judicial interpretations by this Court of the Due Process and Commerce Clauses of the Constitution and (2) to show the national detrimental effect that decision will have unless the Court establishes fair apportionment standards.

COST therefore urges that leave be granted to file a brief as *amicus curiae* and respectfully so moves the Court.

Respectfully submitted,

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October, 1981

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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce as *amicus curiae* in support of the Jurisdictional Statement in the above-captioned case.

OPINIONS BELOW

The Opinion of the Court of Appeal of California, First Appellate District, is reported at 117 Cal. App. 3rd 988, 173 Cal. Rptr. 121 (1981); the memorandum opinion and judgement of the California Superior Court are not reported.

INTEREST OF *AMICUS CURIAE*

The interest of the Committe on State Taxation of the Council of State Chambers of Commerce is set forth in the accompanying Motion for Leave to File Brief *Amicus Curiae.*

SUMMARY OF ARGUMENT

California, for corporate franchise tax purposes, may compute the taxable base by application of an apportionment formula to the total "unitary" income of a taxpayer. The apportionment formula utilized to determine the amount of income attributable to the state includes three factors: property, sales and payroll.

The Court has long approved a state's use of an apportionment formula to derive income attributable to business conducted within the state. Application of a formulary apportionment method, however, must not produce unreasonable or grossly distorted results.

A basic assumption underlying the equitableness of an apportionment formula is that property and labor will produce approximately the same amount of income wherever located. That assumption can be shattered when such an apportionment formula is applied beyond the borders of the United States to "combined" companies operating in foreign countries. An arbitrary or distorted result is then produced as a result of the broad economic, political and social differences which exist between this country and most of the remainder of the world.

Inclusion of income of subsidiaries operating outside the United States in the apportionable base results in an

attribution of income so arbitrary as to offend the Due Process Clause of the Fourteenth Amendment and is violative of the Commerce Clause because it (1) constitutes an unreasonable burden on foreign commerce and (2) is contrary to, and interferes with, the established tax policy of the United States.

ARGUMENT

Distortion

The apportionment formula method has developed as a mechanism to apportion net income among taxing jurisdictions on the basis of the ratio that the corporate taxpayer's economic activities or values within a particular state bear to the total of such activities or values both within and without that particular taxing jurisdiction. Most of the states, including California, use a three-factor formula of property, payroll and sales. Implementation of this formula varies among the states. Under the California "combination" formula, the state apportions income by multiplying the total "unitary" income of the corporate taxpayer, its subsidiaries and affiliates, wherever earned, by a percentage derived from the average of the payroll, property and sales in California over total payroll, property and sales wherever located.

Fundamental to the equity of an apportionment formula is the need for all of the taxing jurisdictions to have roughly comparable factors, i.e., every dollar of sales, payroll and property must produce approximately the same amount of income regardless of where the business is being conducted. Within these limits, the use of the three-factor formula provides a fair measure of the total income earned by the business enterprise within the state and apportions the total tax burden among the various states.

The three-factor formula does not provide a fair measure when it is applied on a "worldwide combined" basis. Wage rates and productivity of labor differ substantially between the United States and most foreign countries. Major differences also exist in the costs and productivity of plant, equipment and other property. Property values and payroll costs tend to be higher in the United States than elsewhere. This distortion causes an excessive amount of income to be attributed to the "worldwide combination" state. *State Taxation of Foreign Source Income: Hearings on H.R. 5076 Before the House Comm. on Ways and Means,* 96th Cong., 2d Sess. 167 (statement of Paul W. Cook); 193-194 (statement of Dallas A. Hurston); 259 (statement of William O. Hetts) (1980).

Due Process

The Court has repeatedly sanctioned application of an apportionment formula method for the purpose of state taxation of the income of a business operating in interstate commerce. It has long been established that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the states for tax purposes by formulas utilizing in-state aspects of interstate affairs". *Exxon Corp.* v. *Wisconsin Department of Revenue,* 447 U.S. 207, 219 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U.S. 425, 436 (1980); *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450, 460 (1959).

Where a state seeks to impose a tax on income generated by interstate and intrastate activities, the Due Process Clause of the Fourteenth Amendment requires that there be a " 'minimal connection' between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the intrastate values of the enterprise". *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U.S. at 437. *See Moorman Mfg.*

Co. v. *Bair,* 437 U.S. 267, 272-273 (1978). If an apportionment formula results in the taxation of income out of all reasonable proportion to the corporation's business activities within the state, the formula violates the Due Process Clause.

Where an apportionment formula is applied on a "worldwide combination" basis, there is no rational relationship between the income attributed to the state and the intrastate values of the business enterprise. There are vast disparities in the productivity of payroll and property between the United States and most foreign countries. Thus, the inclusion of foreign operations in the apportionment formula results in gross distortion, both as to factor percentages used to determine the ratio of apportionable income and the correlative amount of income attributed to the state, out of all proportion to the business transacted within the state.

The difficulties inherent in fairly apportioning income among the various states in which a business is conducted have long been recognized. *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113, 120-121 (1920). Accordingly, the Court has ruled that the Commerce and Due Process Clauses of the United States Constitution require "rough approximation rather than precision" in a formula which apportions income of such an enterprise. *International Harvester Co.* v. *Evatt,* 329 U.S. 416, 422 (1947).

Nevertheless, the latitude offered the states is not total. If a taxpayer shows that "the method of apportionment adopted by the State was inherently arbitrary, or that its application to this corporation produced an unreasonable result", *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. at 121, or that the income attributed to the state was "out of all appropriate proportion to the business transacted . . . in that state", *Hans Rees' Sons* v.

North Carolina ex rel. Maxwell, 283 U.S. 123, 135 (1931), or that the formula "led to a grossly distorted result", *Norfolk & Western Railway Co.* v. *Missouri State Tax Commission,* 390 U.S. 317, 326 (1968), then Due Process has been violated. *See Exxon Corp.* v. *Wisconsin Dept. of Revenue,* 447 U.S. at 220; *Moorman Mfg. Co.* v. *Bair,* 437 U.S. at 274.

Commerce Clause

Japan Line, Ltd. v. *County of Los Angeles,* 441 U.S. 434 (1979), sets forth the governing principles under the Commerce Clause. There, the Court reiterated the standard applicable to a tax on interstate commerce. "If the state tax 'is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state,' no impermissible burden on interstate commerce will be found." *Japan Line, Ltd.* v. *County of Los Angeles,* 441 U.S. at 444-445. *See Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274, 279 (1977); *Washington Revenue Dept.* v. *Washington Stevedoring Cos.,* 435 U.S. 734, 750 (1978).

With respect to state taxation which impacts foreign commerce, the Court explained in *Japan Line* that two additional standards must be met (441 at 446, 448):

> "When a State seeks to tax the instrumentalities of foreign commerce, two additional considerations beyond those articulated in *Complete Auto,* come into play. The first is the enhanced risk of multiple taxation.
>
> * * *
>
> "Second, a state tax on the instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential."

The Court then held that "[i]f a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause". 441 U.S. at 451.

The first test enunciated relates to the enhanced risk of multiple taxation and is herein applicable. Application of the apportionment formula method on a "worldwide combination" basis creates more than the risk of multiple taxation. In the instant case, it *does* produce multiple taxation. Income of each subsidiary is taxed in the foreign country in full and without any apportionment. By applying the apportionment method on a "worldwide combination" basis, income which has already been fully taxed in the foreign countries is attributed to California under the three-factor formula. Thus, to the extent such income is apportioned to California, it is indeed subjected to double taxation. *State Taxation of Foreign Source Income: Hearings on H.R. 5076 Before the House Comm. on Ways and Means,* 96th Cong., 2d Sess. 193 (statement of Dallas A. Hurston); 315 (statement of Joseph H. Guttentag) (1980). Other states, which have or may adopt this worldwide approach, may subject this same foreign income to further taxation. Thus, state taxation under the "worldwide combination" apportionment formula method results in multiple taxation of foreign commerce.

The rationale of *Japan Line* is fully applicable in the instant case. The Constitutional limitations which apply to state taxing powers do not differentiate among different kinds of taxes. Taxes which result in multiple burdens on interstate or foreign commerce are invalid regardless of the kind of tax involved. *See, e.g., Evco* v. *Jones,* 409 U.S. 91 (1972); *Standard Oil Company* v. *Peck,* 342 U.S. 382 (1952). The gravamen of an invalid tax is its burden on commerce and not what it is called or to what asset it is applied.

Application of the apportionment formula method on a "worldwide combination" basis also violates the second test of *Japan Line* in that it impairs "federal uniformity in an area where federal uniformity is essential." 441 U.S. at 448. Under federal tax policy, the income of the parent and the income of subsidiaries operating outside the United States are determined on a separate corporate basis. Indeed, the major trading nations of the world and the tax treaties between the United States and other countries also apply this separate corporate entity approach pursuant to the internationally-accepted arm's length standard. The separate entity method and the "worldwide combination" method often apportion income as between countries quite differently. As a result, the "worldwide combination" method inevitably conflicts with the federal method making federal uniformity impossible in the field of foreign commerce, an area where the Court stated in *Japan Line* that federal policy must be supreme.

The "worldwide combination" apportionment method indirectly impacts foreign commerce in contravention of the principles promulgated in *Japan Line*. This circumvention should not be allowed.

CONCLUSION

For all the foregoing reasons, COST urges this Court to note probable jurisdiction in the present case and give plenary consideration to the Due Process Clause and Commerce Clause questions discussed in Appellant's Jurisdictional Statement.

Respectfully Submitted,

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